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INSIGHTS ON...

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INSIGHTS ON...

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An overview of Canada's information technology sector

- software, hardware manufacturing and communications infrastructure all make up this dynamic sector. This article examines Canada's product specialization, trade, employment and R&D.

What's new in business and trade statistics?

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The evolving role of wholesalers

L.A. Murphy*

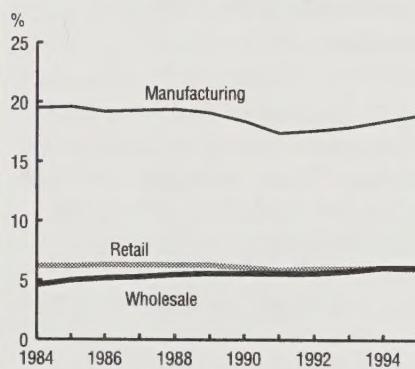
Rather than get squeezed in the push for greater efficiencies, wholesalers have found new ways to help markets function. This article, based on the author's discussions with wholesalers, looks at the changing role of wholesalers—their relationships with customers and the diversification of services that they offer.

Since the mid-1980s wholesale trade has been a dynamic force in the Canadian economic landscape, growing at a faster rate than the economy as a whole. Indeed, since 1991 the growth of wholesale trade has been accelerating, compared to much more moderate growth in the retail and manufacturing sectors. As a result, wholesale trade represented 6.1% of gross domestic product in 1995, compared with 4.6% just over a decade earlier (Figure 1). Similar but less marked tendencies have been observed in the United States.

Wholesalers have managed not only to maintain but increase their role in the economy. How have they done this? One factor may be the trend towards globalization, whereby efficiency is enhanced through the centralization of production and efficient distribution networks, in which wholesaling plays a key role. Also important, however, is the expanding role of wholesale trade itself. As their clients focus on their core business, wholesalers are playing an increasingly important role in their customers' non-core activities, diversifying into a myriad of functions which entail much more than simply buying and selling goods.

Figure 1

Share of GDP, selected sector, 1984-1995



Wholesalers cater to a broad range of customers

Wholesalers act as intermediaries among a broad range of customers. Although retailers are the single largest customer group for wholesalers, they generated just 34% of wholesalers' total revenues in 1994. Other customer groups include industrial and commercial clients (accounting for 31% of sales by wholesalers), other wholesalers (17%), exports (11%), household consumers (4%) and farmers (4%).

The extent to which products are sold to retailers varies considerably. For example, wholesalers of tobacco products, drugs and toilet preparations sell 90% of their goods to retailers, while only 3% of sales by merchants of metal and metal products are to retail outlets.

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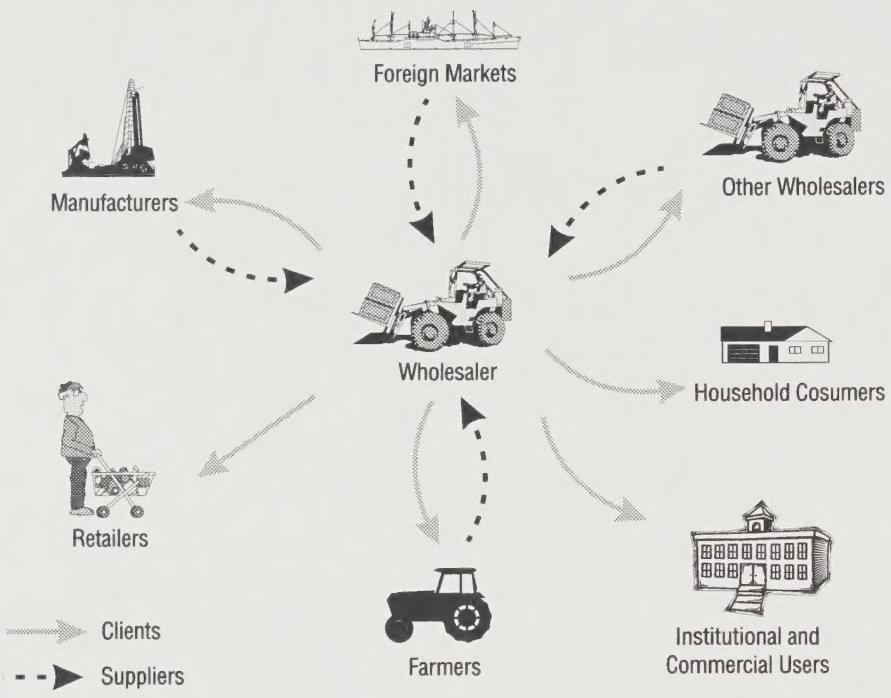


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Figure 2

Wholesale supply and distribution network



Functions performed by wholesalers

As key intermediaries, wholesalers have had to respond to the new demands of the marketplace. Today, wholesalers are much more than just middlemen. Buying and selling goods continues to be a wholesaler's primary function, but as margins have shrunk and competition has intensified, some wholesale merchants have taken on additional tasks and risks.

The services a wholesaler provides vary considerably and depend on the types of goods involved. For example, a wholesaler of road graders, in addition to selling the basic equipment, may also maintain repair facilities, stock replacement parts, and dispense technical advice to current and prospective clients. The same vendor may also research the utility of new products. Such extensive activities are in marked contrast to a food wholesaler, who is unlikely to experience demand for such services.

Although data are not yet readily available on the extent to which wholesalers provide these types of services, it is recognized

that an increasing number of merchants are providing a wide range of "extras" to capture or maintain market share. Some of the principal activities into which wholesalers have diversified are described below.

Transportation plays a key role in guaranteeing delivery, and so it is hardly surprising that many wholesalers provide transportation services to move goods from the factory to market. With the growth of just-in-time inventory practices, which require that products are available at a specific time and in sufficient quantity at a given location, warehousing has become an increasingly critical service. Wholesalers may also engage in processing activities, frequently sorting and packaging goods from large numbers of manufacturers and importers for distribution to retailers or to an even wider range of wholesalers.

Information technology for market research With cost structures and profit margins becoming tighter, manufacturers are increasingly focussing on production and relying on wholesalers for market information. In this context, information technology is bringing sweeping changes to the ways wholesalers do business. As Electronic Data Interchange (EDI) takes

hold, time and distance—vital considerations in the distributive trades—can be bridged more rapidly. Initial hesitation by manufacturers to share product information with wholesalers and retailers has been dwindling given the opportunity of data-sharing to reduce costs. As a result, suppliers are now forging alliances with wholesalers capable of contributing to market research and product development.

Many types of information are exchanged. They include inventory management information which, through linkages to point of sale/purchase data, result in faster turnaround times for customers. Wholesalers' input into market research and product development takes the form of the collection of product specifications and technical analysis of equipment. In addition, electronic networks facilitate the exchange of information concerning advertising campaigns and special offers.

Standardization, grading and product certification are dictated to some extent by government legislation. CSA labels are well known to many consumers; however, certain industry groups have developed their own packaging and labeling standards. A prerequisite for efficient data communication is standardization of methods and files. The emergence of EDI, standard stock-keeping units (SKUs) and the sharing of classification codes are examples of a coordinated approach by manufacturers, wholesalers and retailers.

Quality of service is taking on new significance, with implications for the market share both of wholesalers and their customers. Quality of service has far-reaching effects. It ranges from pre-sales considerations such as maintenance policy, minimum stock levels, order processing, and just-in-time deliveries with supporting guarantees, to after-sales considerations such as work done under warranty, settlement of complaints and replacement parts. It may include risk-bearing, which, although difficult to measure, is an implicit wholesale function: market forces may cause price levels to change, resulting in a loss in value, while physical risks such as fire and theft are also borne by the wholesaler. In supplying retail stores, wholesalers' representatives (known as "rack jobbers") are taking increasing

responsibility for replenishing store shelves.

Financing is another non-traditional service for wholesalers but can often make the difference between an enquiry and a sale. The extension of credit can often facilitate transactions and is usually provided by the wholesaler as a service to clients. In the case of major equipment, credit packages often eliminate the need to arrange bank financing. This is especially convenient for smaller businesses. As well, customers frequently utilize the typical 30-day interest-free period on accounts granted by wholesalers for short-term investment purposes.

Economic implications

The diversification of wholesale trade is having far-reaching implications for suppliers, purchasers and distribution networks. The functions performed by the wholesaler can be considered from a customer's or a supplier's perspective. From a customer's standpoint, wholesalers must anticipate their requirements, producing the right merchandise at the right time, at the right price, and in the right amounts. To achieve these objectives, some wholesalers make use of computer-based models to estimate future demand. In any event, customer planning

is a continuous process: as soon as changes in demand are determined, new merchandise must be ordered or old merchandise disposed of. In this context wholesalers frequently need to identify upcoming trends or products no longer in demand.

Wholesalers bring together a wide assortment of goods, sometimes carrying in excess of 20,000 SKUs to ensure that customers can select from a wide variety of stock. And since prompt delivery is essential to the smooth operation of the distribution system, wholesalers must maintain adequate stocks on hand to cover urgent needs. This means that wholesalers engage in relatively large-scale buying practices, producing a number of beneficial spin-offs: lower unit prices than could be realized by individual buyers; certain freight economies; and minimum stock levels needing to be maintained by clients which would otherwise tie up capital. Wholesalers also have a role in guaranteeing goods and helping to resolve complaints. The customer relies on a wholesaler's ability to assess the quality of the goods carried and ensure that all the manufacturer's claims and guarantees are met.

From a supplier's perspective, the wholesaler assists in providing new product

information, sales planning, special promotions, supplementary advertising, suggested list prices, and product advisory services. In this context, geography is an important factor. The large distances between manufacturing plants and retail outlets often make it more convenient to use wholesalers as intermediaries.

Wholesalers are generally closer to the marketplace, and are able to pass on much valuable market intelligence that helps the manufacturer determine the type, quantity, size and packaging of goods.

In addition, the wholesaler helps the manufacturer stabilize production schedules by ordering goods considerably in advance of the needs of customers. This means that a manufacturer who markets through a wholesaler is not as exposed to short-term downturns as if it sold directly to a retailer.

The wholesaler also assists manufacturers by providing storage facilities to maintain adequate stocks on hand. Given the lead time required to produce an order, manufacturers ship goods to wholesalers as fast as they are produced. Wholesalers optimize their warehouse space with several types of merchandise, particularly where goods are seasonal.

Product shares

The wholesale trade sector (excluding grain and petroleum) is concentrated among three major trade groups which make up about two-thirds of the industry. Food, beverages, drugs and tobacco products represent almost one-quarter of wholesale trade (Table 1).

In the past, sales of these goods have tended to be impervious to the business cycle, reflecting demographic factors instead. But the growth experienced over the past several years cannot be explained by demographics alone. Wholesale trade of prepared food products has outpaced domestic production. At the same time, imports

have risen sharply, particularly those from the United States. In 1989, 44% of imports of prepared foods originated in the United States, while by 1994 the proportion was close to 60%. The sharp rise in imports is possibly explained by increased demand for a wider variety of goods, particularly specialty products such as ethnic and health foods, which may not have been fully met by domestic producers.

Table 1

Trade groups as shares of wholesale merchants' sales

	1995
Total	100.0
Food, beverages, drugs and tobacco products	23.4
Apparel and dry goods	6.3
Household goods	3.1
Motor vehicles, parts and accessories	10.9
Metals, hardware, plumbing and heating equipment and supplies	8.0
Lumber and building materials	8.5
Farm machinery, equipment and supplies	2.5
Industrial machinery, equipment and supplies	15.3
Computers and packaged software	8.7
Other products	17.5

Non-farm machinery, equipment and supplies is made up of industrial machinery and equipment and computer equipment and software. Computer equipment and software account for about one-third of sales of this trade group.

"Other products", which account for about 18% of wholesale trade, mainly comprise export-oriented commodities such as pulp and paper, industrial chemicals, fertilizers and miscellaneous forest products.

Summary

Substantial growth in the wholesale trade sector in recent years can be explained by a number of factors. Wholesalers are important conduits in facilitating imports and exports both in North America and overseas. In this context, recent developments have had a major impact. There is mounting evidence—much of it anecdotal—to suggest that free trade is encouraging production/distribution realignments, involving the centralization of manufacturing facilities and placing greater reliance on distribution networks. These changes are consistent with recent marked increases in trade flows between Canada and other countries, with ramifications also for interprovincial trade as traditional east/west movements are giving way to a north/south axis.

But perhaps the key change for the wholesale trade sector results from the need for cost minimization. Under the pressure to minimize costs, businesses are increasing efficiency through the rationalization of production and distribution. In some cases this means providing goods to the marketplace through imports rather than domestic manufacturing. In this context wholesalers are emerging as dynamic agents of change, acting as conduits to new markets, both domestic and foreign. While the wholesaler's traditional role as an intermediary between producers and retailers is still vital, it is expanding to exploit the potential of new information technologies, changes in public policy, and the forging of commercial alliances. Wholesalers may still be middlemen, but the middle is clearly expanding.

Sources

Data from the following Statistics Canada sources were used in this article:

- *Provincial Gross Domestic Product by Industry* (Catalogue no. 15-203-XPB)
- *Imports by Commodity* (Catalogue no. 65-007-XPB)
- *Wholesale Trade* (Catalogue no. 63-008-XPB)
- *Canadian Business Patterns* (Product no. 61F0040XDB)

An overview of Canada's information technology sector*

Information technology is a dynamic, multifaceted sector of the Canadian economy. It is at the leading edge of technology, exhibiting rapid and at times radical change. The sector is composed of large numbers of small, rapidly growing companies as well as some very large, long-established ones. Information technology covers a broad spectrum. It is not easily defined, but includes three essential elements: hardware, software, and infrastructure. In this *Industry Profile*, hardware is defined to include the hardware manufacturing industries; software includes software and service companies; and infrastructure consists of telecommunications carriers.

Canada a world leader in telecommunications technologies

By international standards, Canada is a small but specialized producer of information technologies. Canada accounted for only 1% of world exports in information technology products in 1992, but has earned a reputation as a world leader in telecommunications. Canadian

This article is abstracted from a forthcoming publication entitled Industry Profile — Canada's Information Technology Sector (Catalogue 15-516-MPE, \$18). For more information on this article or Industry Profiles, contact Fred Wong at (613) 951-2994 or frewong@statcan.ca.

communications equipment companies such as Northern Telecom, Bell-Northern Research, MITEL and Newbridge Networks have established a substantial presence in highly specialized market segments. They have benefited from a close working relationship with companies such as Bell Canada and Rogers Cable Systems, which have created networks for telephone, satellite, cable and cellular systems spanning the continent, and are now at the forefront of the "information highway."

In recent years, Canada has also emerged as a major producer of software and computer services through firms such as SHL Systemhouse, Cognos, DMR and Corel, the latter recently gaining prominence through the acquisition of the world-renowned WordPerfect software systems. As a manufacturer of information technology hardware, moreover, Canada benefits from the presence of

multinationals such as IBM, Digital and Hewlett Packard.

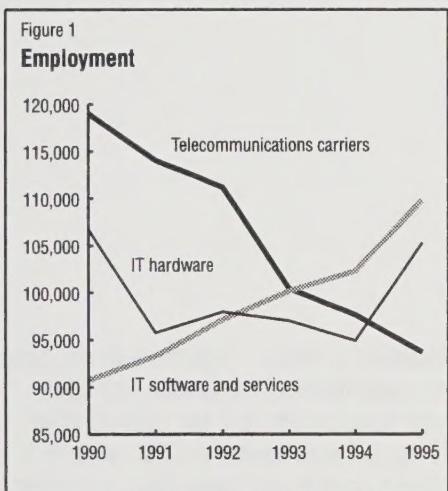
A significant part of the Canadian economy

Information technology is a significant part of the Canadian economy. In 1995, it accounted for 7.6% of Canada's gross domestic product (GDP) at factor cost, up from 5.5% in 1990. Although comprising a wide variety of activities, some of them are particularly prominent. Among hardware manufacturing industries, communications equipment and computer technologies are substantial, supporting a workforce of 71,000 employees. In the software category, software and computer services has been a growth industry, with employment rising by 21% from 64,000 in 1990 to 77,000 in 1995. And in the infrastructure category telephone companies are the dominant group, followed by the emerging but much smaller cable and cellular telecommunications carriers.

The information technology sector supported a workforce of 308,000 in 1995, almost 3% of total employment in Canada. The recession and corporate downsizing

* This article was prepared in the Business and Trade Analysis and Integration Unit by Fred Wong, under the direction of Roger Purdue.

were reflected in declining employment from 1990 to 1994, before the industry recouped most of its job losses in 1995. The net reduction of the workforce resulted mainly from structural re-engineering by telecommunications carriers, where the combined effects of the 1990-91 recession and increasing use of automated systems saw a loss of over 25,000 jobs - some 21% of the industry total - from 1990 to 1995. A further 8,500 jobs disappeared among producers of computers and office equipment, scientific and professional equipment and the small consumer electronics category. These declines contrasted with the situation in the communications equipment and software and service industries, where employment rose by 26,000.



Product specialization and high levels of trade

International trade and the specialization of production are integral characteristics of the information technology sector, and are reflected in high volumes of two-way trade. Canadian manufacturers are highly export-oriented, with exports as high as 70% of factory shipments. At the same time, imports of information technology products are actually greater than domestic production (Table 1). Canada's trade deficit in information technology products amounted to \$18.6 billion in 1995 after growing by about 14% a year since 1990. Data on trade in services are incomplete, but suggest that exports of software and computer services are increasingly important. Although small relative to trade

in hardware, they almost tripled from \$515 million in 1990 to \$1.5 billion in 1995.

The importance of trade reflects the high degree of specialization within the industry. For example, Canadian firms have established particular expertise in communications equipment, whereas the mass market for consumer electronics is largely sourced from the United States and offshore. A further inducement to trade has been the implementation of the North American Free Trade Agreement (NAFTA) and its precursor, the Canada-U.S. Trade Agreement. Although tariffs have not represented a particular barrier to trade in the information technology sector, the introduction of NAFTA may be expected to result in increased specialization of production, including more extensive use of global product mandates for Canadian plants of multinational enterprises, and even higher levels of North American and international trade.

Increased use of information technologies in manufacturing

The high proportion of imports into Canada reflects not only the openness of the Canadian economy to trade, but also investment in cutting edge technologies by Canadian corporations to maintain their competitiveness in international markets. The use of information technologies, such as CAD/CAE (computer aided design/computer aided engineering), numerically controlled equipment and pick-and-place robots, is increasingly common among Canadian industries. In 1993, investment in computerized industrial, office and business machinery and equipment amounted to an estimated \$11.9 billion, or slightly more than one-quarter of total outlays on all types of machinery and equipment in Canada. Moreover, 35% of Canadian manufacturing establishments, accounting for 81% of total factory shipments, used at least one type of

advanced technology in their operations. Plants using more than five different advanced technologies were responsible for 59% of all factory shipments, a proportion expected to rise to more than 70% within two years.

To remain at the forefront in highly competitive markets, the information technology sector is heavily involved in research and development (R&D). Each year the information technology sector spends about \$2.3 billion and employs some 23,400 people in R&D. The sector is responsible for slightly more than one-half of R&D by all Canadian manufacturing industries, and one-third of total industrial R&D in Canada. These outlays contrasted with a net decline in capital expenditures by the information technology sector over the past five years, although the output/capital ratio - an indicator of the efficiency with which capital was employed - increased substantially during this period.

High value added, profit potential

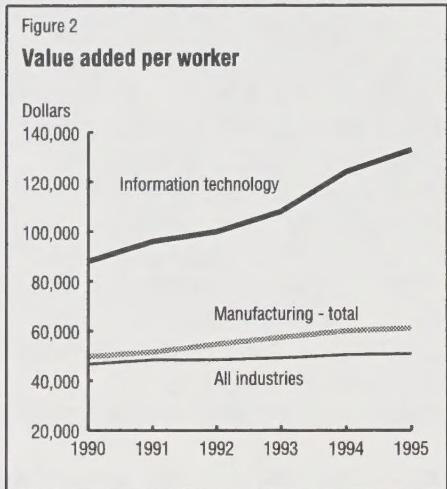
Information technology is a high value added sector. Its value added is equivalent to about 65% of gross output, compared to 30% for the manufacturing sector as a whole. Labour productivity (as measured by value added per worker) is also very high and rising, reflecting gains in output and a declining workforce. Labour productivity rose by 51% over the 1990-95 period, compared to 23% for the manufacturing sector as a whole and 9% for all industries. Further evidence of productivity improvement is provided by a significant increase in the output/capital stock ratio, indicating more efficient use of fixed assets by hardware manufacturers.

Buoyant demand for information technology products boosted operating revenues of electronic equipment and computer services companies by 60% between 1990 and 1995. The industry posted substantial

Table 1
Information technology - hardware

	1990	1991	1992	1993	1994	1995
Gross output (shipments)	12 806	14 730	15 701	15 942	19 557	23 591
Exports	8 878	9 517	10 431	10 990	14 078	17 223
Imports	18 363	19 333	21 747	24 858	30 689	35 781

profits in 1990, followed by a large decline in 1991 with the onset of the recession. Profits fluctuated in 1992 and 1993, but in 1994 the combination of a resurgent economy and strong demand for information technology products pushed net profits to record levels before easing somewhat in 1995. For telecommunications carriers, the financial results were relatively stable throughout the period.



Sources

Data from the following Statistics Canada and OECD sources were used in this article:

- OECD, *Main Economic Indicators*
- OECD, *Structure Analysis (STAN) Data Base*
- Statistics Canada, *Software Development and Computer Service Industry* (Catalogue no. 63-222)
- Statistics Canada, *Industrial Research and Development* (Catalogue no. 88-202-XPB)
- Statistics Canada, *Cable television*, (Catalogue no. 56-205)
- Statistics Canada, *Telephone statistics*, (Catalogue no. 56-203)
- Statistics Canada, *Manufacturing industries of Canada: national and provincial areas* (Catalogue no. 31-203)
- Statistics Canada, *Financial statistics for enterprises* (Catalogue no. 61-219)

What's new in business and trade statistics?

Industry Profiles...a composite picture of Canada's key economic sectors

Industry Profiles are a new series of publications on Canada's key economic sectors. They are a useful digest and reference tool based on a wide range of Statistics Canada data. Their user-friendly and concise format features pertinent commentary and easy-to-follow tables and charts. Each *Industry Profile* focuses on a sector's operating characteristics and performance, as reflected in key economic indicators, such as output, international trade, labour market information, investment, productivity, research and development and profits. International comparisons are also provided based on data from the OECD's Structural Analysis (STAN) Database. The *Industry Profiles* scheduled for release this fall are *Canada's Food Processing Industry* (October, catalogue 15-515-MPE), *Canada's Information Technology Sector* (November,

catalogue 15-516-MPE), and *Canada's Machinery Industry* (December, catalogue 15-517-MPE). *Industry Profiles* are available for \$18 per issue. For further information, contact Fred Wong (613-951-2994; frewong@statcan.ca), Business and Trade Analysis and Integration.

Financial performance indicators

A new publication called *Financial Performance Indicators for Canadian Business*, in three volumes, is an authoritative reference for key financial ratios by industry. It is based on up-to-date, comprehensive financial statements reported by businesses. The indicators provide financial performance benchmarks by industry.

Volumes 1 and 2 show fifteen commonly used financial ratios, the proportion of firms experiencing profits, and balance sheet structures where items are expressed as percentages of total assets,

liabilities or equity. Volume 3 shows three principal financial ratios plus year-over-year sales growth and the percentage of firms that experienced profits. Volume 1 covers medium and large firms with sales revenue over \$5 million. It is based on 1995 data and covers all industries. Volumes 2 and 3 both cover small- and medium-sized firms with sales revenue between \$50,000 and \$25 million in the non-financial sectors. Volume 2 is based on 1993 data; Volume 3 has comparative data for 1993, 1994 and 1995. The three volumes of *Financial Performance Indicators for Canadian Business* (Catalogue 61F0058XPE/F, \$170; 61F0059XPE/F, \$190; and 61F0060XPE/F, \$210) are available from Gail Sharland at (613) 951-9843 or internet at campbeg@statcan.ca. For further information, contact Jack Wilson, Industrial Organization and Finance Division, at (613) 951-2656.

NAICS: The new industry classification standard

Statistics Canada has developed a new North American Industry Classification System (NAICS) in cooperation with the statistical agencies of the United States and Mexico. In Canada, NAICS will replace the 1980 Standard Industrial Classification currently in use. Following its official ratification in December 1996, it is expected that most annual business surveys of Statistics Canada will use this new classification starting with reference year 1997.

In addition to permitting better comparisons of data between the three countries, NAICS will provide an updated representation of Canadian industries. Several sectors, particularly those relating to service industries, are better articulated in the new classification; examples are professional, scientific and technical services, management and support services, waste management, and information and cultural industries.

The NAICS system of hierarchy and coding differs from the Canadian 1980 Standard Industrial Classification in that a four level, 4-digit system is replaced with a 5 level, 6-digit system . The first four levels of

NAICS are designed for the production of comparable statistics between the three countries. At the fifth level each country has additional detail for its own purposes. The structure of NAICS can also be downloaded from the Internet at www.statcan.ca. Select Virtual Library, then Information by subject and finally Classification.

For further information, contact Mr. Kim Farrall (613-951-4245) or the Director of Standards Division, Ms. Shaila Nijhowne (613-951-8576); fax (613-951-8578); Internet_standards@statcan.ca.

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Canada owes the success of its statistical system to a long-standing co-operation involving Statistics Canada, the citizens of Canada, its businesses, governments and other institutions. Accurate and timely statistical information could not be produced without their continued co-operation and goodwill.

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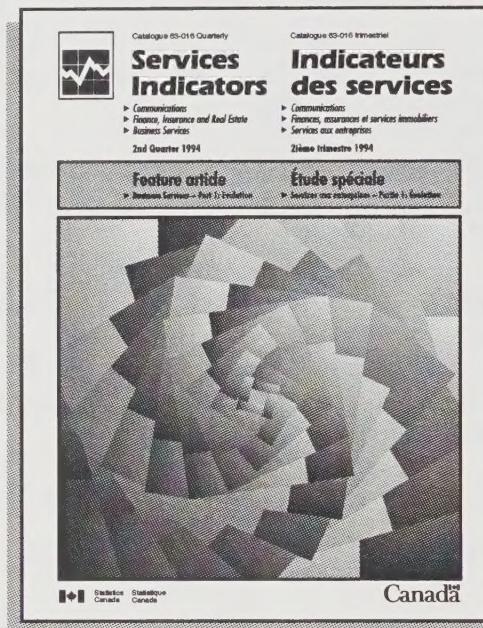
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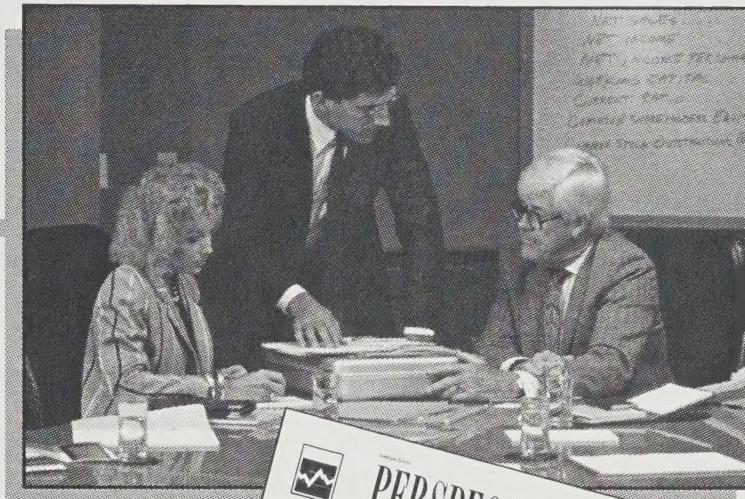
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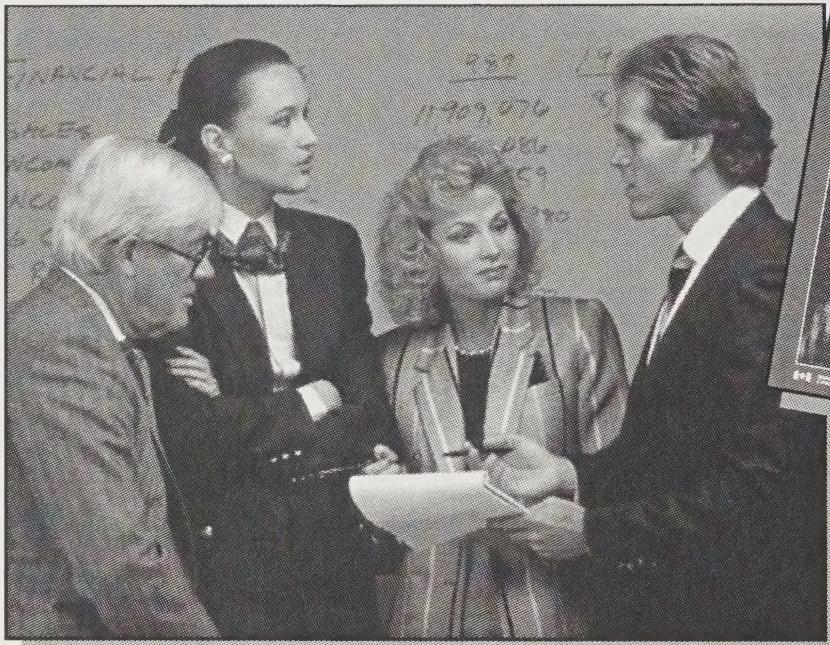
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